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Research Update:

Wisconsin Energy And Integrys Ratings Affirmed On Announced Merger; Certain Outlooks Revised To Negative From Stable

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Overview

- Wisconsin Energy Corp. (WEC) is acquiring Integrys Energy Group Inc. for $9.1 billion.
- We are affirming the ratings on utility holding company WEC and its subsidiaries Wisconsin Electric Power Co. (WEPCO) and Wisconsin Gas LLC (WG). We have also affirmed the ratings on utility holding company Integrys and its subsidiaries Wisconsin Public Service Corp. (WPS), Peoples Gas Light & Coke Co. (PGL&C), and North Shore Gas Co. (NSG).
- We believe that WEC's acquisition of Integrys will enhance the company's position within the "excellent" business risk profile category.
- Although WEC's financial measures will weaken somewhat, we believe that the overall financial risk profile will remain within the "significant" financial risk profile category.
- We have revised the credit outlooks on WEC, Integrys, PGL&C, and NSG to negative from stable.
- The outlooks on WEPCO, WG, and WPS remain stable, reflecting sufficient regulatory insulation, their stand-alone credit profiles, which would be unaffected by the transaction, and our expectations that ratings on parent WEC are unlikely to be lowered more than a one-notch.

Rating Action

On June 23, 2014, Standard & Poor's Ratings Services affirmed its ratings on WEC and WEPCO, including their 'A-' issuer credit ratings. We also affirmed the ratings on WG, including its 'A' issuer credit rating. We also affirmed the 'A-2' short-term/commercial paper ratings on WEC and WEPCO and the 'A-1' short-term/commercial paper rating on WG.

At the same time, we affirmed our ratings on Integrys, WPS, PGL&C, and NSG, including their 'A-' issuer credit ratings. We also affirmed the 'A-2' short-term/commercial paper ratings on Integrys, WPS, and PGL&C.

Standard & Poor's revised its credit outlook on WEC to negative from stable. We also revised our credit outlook on Integrys, PGL&C, and NSG to negative from stable. The outlooks on WEC's subsidiaries WEPCO and WG and Integrys' subsidiary WPS remain stable because the transaction does not affect their stand-alone credit profiles and because of sufficient regulatory insulation.

Rationale

The negative outlook on WEC, Integrys, PGL&C, and NSG reflects the potential negative effect on WEC's consolidated financial measures of the company's announced $9.1 billion acquisition of Integrys. We expect that the incremental debt associated with this transaction will weaken WEC's financial measures. Therefore, we believe that the company's consolidated financial risk profile could fall toward the lower end of our "significant" financial risk profile category, leaving little room for underperformance relative to our forecast. A one-notch downgrade would be warranted if the adjusted funds from operations (FFO)/total debt ratio failed to improve in line with our expectations, and remained below 15% on a sustained basis.

On June 23, 2014, WEC entered into an agreement to acquire Integrys for $9.1 billion, which includes the assumption of about $3.3 billion of Integrys' debt. From a qualitative standpoint, the acquisition will strengthen WEC's position within the "excellent" business risk profile category because it enhances scale, scope, operational, geographical, and regulatory diversity. We view the addition of more gas distribution and transmission operations favorably because we regard those businesses as having somewhat lower risk than the vertically integrated electric operations. Because we consider the unregulated businesses as having significantly higher business risk than the regulated utility operations due to competitive pressures and greater variability in cash flow generation, the company's commitment to sell or wind down Integrys' energy supply business and limit growth in the solar business so that 99% of the company's EBITDA is regulated also supports the "excellent" business risk profile.

Our excellent business risk profile assessment incorporates "very low" country risk (U.S.) and our view of the regulated utility sector as having a "very low" industry risk profile that reflects the essential nature of the utility services provided, has material barriers to entry, and essentially operates as a monopoly insulated from market challenges. The utility industry generally exhibits substantial stability in terms of usage and consumption, even after accounting for energy conservation efforts and the economy. The business risk profile is also characterized by strong overall profitability, efficient operations, and above-average scale, scope, and diversification with a very large customer base in multiple states. Importantly, we recognize that WEC has effectively managed regulatory risk in Wisconsin and Michigan, state jurisdictions that we view as "strong," and we expect that management will continue to do so, especially in the more challenging Illinois regulatory jurisdiction, which we assess in the bottom half of the "strong/adequate" category.

Due to WEC's plans to fund the transaction with a combination of debt and common stock, we believe that the company's financial measures could fall to the weaker end of our "significant" financial risk profile category based on our medial volatility table, leaving little cushion for underperformance relative to our forecast. In that regard, adjusted FFO to total debt might weaken to below 15% and debt to EBITDA could increase to above 4x for several years following the acquisition.

WEC aims to complete the transaction in mid-2015, subject to certain closing conditions, including approvals from shareholders, state regulators in Wisconsin, Illinois, Michigan, and Minnesota, the Federal Energy Regulatory Commission, and the Federal Communications Commission, as well as the expiration of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act.

Liquidity

WEC and Integrys have "adequate" liquidity to cover their needs over the next 12 months. We expect that the companies' sources of liquidity will exceed uses by 1.1x or greater, the minimum threshold for an adequate designation under our criteria, and that the company will also meet our other criteria for such a designation.

WEC

Principal Liquidity Sources

- Credit availability of $1.25 billion over the next 12 months.
- FFO of about $1 billion over the next 12 months.

Principal Liquidity Uses

- No remaining debt maturities in 2014 and about $400 million in 2015.
- Capital spending of about $780 million over the next 12 months.
- Dividends of roughly $370 million over the next 12 months.

Integrys

Principal Liquidity Sources

- Credit availability of at least $825 million over the next 12 months.
- FFO of about $850 million over the next 12 months.

Principal Liquidity Uses

- Debt maturities of $125 million in 2015.
- Capital spending of about $1 billion over the next 12 months.
- Dividends of roughly $220 million over the next 12 months.

We would expect that the combined company would have "adequate" liquidity to cover its needs in the 12 months following consummation of the transaction.

Recovery analysis

- We assign recovery ratings to first mortgage bonds (FMB) issued by U.S. utilities, which can result in issue ratings being notched above a utility's Issuer Credit Rating (ICR) depending on the rating category and the extent of the collateral coverage. The FMBs issued by U.S. utilities are a form of "secured utility bond" (SUB) that qualify for a recovery rating as defined in our criteria.
- The recovery methodology is supported by the ample historical record of

100% recovery for secured bondholders in utility bankruptcies in the U.S. and our view that the factors that enhanced those recoveries (limited size of the creditor class and the durable value of utility rate-based assets during and after a reorganization given the essential service provided and the high replacement cost) will persist in the future.
- Under our SUB criteria, we calculate a ratio of our estimate of the value of the collateral pledged to bondholders relative to the amount of FMBs outstanding. FMB ratings can exceed a utility's ICR by up to one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade categories depending on the calculated ratio. We do not notch FMB ratings for companies with ICRs in the 'AA' category.
- The FMBs of WPS and PGL&C benefit from a first-priority lien on substantially all of the respective utility's real property owned or subsequently acquired. Collateral coverage of more than 1.5x supports recovery ratings of '1+' and issue ratings one notch above the ICR.

Group Influence

We consider that there are sufficient measures in place that provide insulation to the Wisconsin utilities that limits the free flow of cash. Most of these provisions are afforded by Wisconsin law and include separateness provisions, dividend restrictions, debt preapprovals, and oversight of the proceeds, and a cap on investments in nonutility assets. In addition, the Wisconsin utilities are further protected given consistent and active regulatory oversight by the Wisconsin Public Service Commission over its operations.

The group credit profile (GCP) of WEC is 'a-' and its issuer credit rating is 'A-'. Under our group rating methodology, we consider subsidiaries WEPCO and WG as integral to the company's long-term strategy and, as such, are highly unlikely to be sold and have a strong commitment from senior management, and therefore we designate them as core entities.

Although there is sufficient regulatory insulation in place, WEPCO's stand-alone financial measures fall within the significant financial risk category under our medial volatility table and therefore do not support credit uplift from the GCP.

WG's stand-alone financial measures reflect an "intermediate" financial risk profile, and support a rating that is one notch higher than the GCP.

Regarding Integrys, its GCP is also 'a-' and its issuer credit rating is 'A-'. We view PGL&C, WPS, and NSG as core subsidiaries of Integrys. We expect to view Integrys, PGL&G, WPS, and NSG as core subsidiaries of WEC when the transaction closes.

Because there are no meaningful regulatory mechanisms in Illinois or other structural barriers that restrict access by Integrys to the assets and cash flow of PGL&C and NSG, the ICRs on PGL&C and NSG are aligned with that of the parent. We would also expect that, post-acquisition, Integrys', PGL&C's, and

NSG's ICRs would also be aligned with that of new parent WEC. In these cases, the businesses and financial risk profiles of the two utilities also result in stand-alone credit profiles of 'a-', which is the same as the GCP.

Although there is sufficient regulatory insulation in Wisconsin to prevent the free flow of cash from WPS to Integrys and, post-acquisition, its stand-alone financial measures fall within the "significant" financial risk category and therefore do not support credit uplift from the GCP.

Outlook

The negative outlook on WEC, Integrys, PGL&C and NSG reflects consolidated financial measures that are toward the lower end of our "significant" financial risk profile category, leaving little room for underperformance relative to our forecast. A one-notch downgrade would be warranted if the adjusted FFO/total debt ratio failed to improve in line with our expectations, and remained below 15% on a sustained basis.

We could revise the outlook to stable if financial measures were to improve following the acquisition so that measures were restored to the middle range of the "significant" financial risk profile category.

Ratings stability for WEPCO, WG, and WPS reflects sufficient regulatory insulation and their stand-alone credit profiles, which would be unaffected by the transaction.

Related Criteria And Research

- General Criteria: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use of CreditWatch And Outlooks, Sept. 14, 2009
- Notching of U.S. Investment Grade Investor-Owned Utility Unsecured Debt Now Better Reflects Anticipated Absolute Recovery, Nov. 10, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; Outlook Revised

	To	From
Wisconsin Energy Corp.		
Wisconsin Energy Capital Corp.		
Corp credit rating	A-/Negative/A-2	A-/Stable/A-2
Integrys Energy Group Inc.		
Corp credit rating	A-/Negative/A-2	A-/Stable/A-2
Peoples Gas Light & Coke Co.		
Corp credit rating	A-/Negative/A-2	A-/Stable/A-2
North Shore Gas Co.		
Corp credit rating	A-/Negative/--	A-/Stable/--

Ratings Affirmed

Wisconsin Electric Power Co.	
Corp credit rating	A-/Stable/A-2
Wisconsin Gas LLC	
Corp credit rating	A/Stable/A-1
Wisconsin Public Service Corp.	
Corp credit rating	A-/Stable/A-2

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